Natural Resources Canada | Ressources naturelles Canada

Deputy Minister | Sous-ministre

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**MEMORANDUM TO THE MINISTER**

## ANALYSIS OF THE FOREST ETHICS REPORT ON FOREIGN INVESTMENT IN THE OIL SANDS

**(Information)**

**SUMMARY**

- This memorandum provides an analysis of the Forest Ethics report entitled *Who Benefits? An Investigation of Foreign Investment in the Tar Sands*, released on May 20, 2012. A more detailed fact-by-fact breakdown of the assertions contained in the Forest Ethics report and a copy of the report itself are provided under Attachment 1.

- The main conclusion reached within the report is that 71 percent of publicly-traded oil companies with active oil sands operations are foreign-owned. Based on this, the report concludes that since 71 percent of all oil sands production is owned by non-Canadian shareholders, the benefits of oil sands development flow out of Canada.

- Forest Ethics' claims with respect to foreign ownership and the benefits that accrue to Canadians are flawed due to confusion between foreign ownership and control and to a misrepresentation of the benefits accruing to Canadians by foreign investment. A fact sheet on foreign investment, ownership and control is found under Attachment 2, along with an explanation of how both Canadian and foreign-controlled companies recycle an overwhelming amount of their revenues back into Canada to create economic growth and jobs.

**BACKGROUND**

On May 10, 2012, Forest Ethics released a report profiling foreign ownership in the oil sands sector. The report concluded that 71 percent of publicly-traded companies with active oil sands operations are foreign-owned, and as a result, Canadians receive little benefit from oil sands development.

Canada

The report: highlights the eastern Canadian crude oil import market; argues that the majority of oil sands operating revenues and profits are directed to foreign companies; and asserts that the sector comprises only a small proportion of Canadian labour market.

Forest Ethics' claims on foreign ownership and the benefits to Canadians are flawed. They are based on an inaccurate conflation of foreign ownership and control and on a misrepresentation of the benefits to Canadians by foreign investment. The Canadian Association of Petroleum Producers (CAPP) took similar issue with the conclusions.

## ANALYSIS

### Forest Ethics' and CAPP's Methodology

Forest Ethics assessed 17 companies operating in the oil sands (representing 95 percent of production), based on investment figures obtained from Bloomberg in January 2012. Forest Ethics' analysis multiplied the percentage of shares held by foreigners by the reported production capacity of each company, such that capacity is proportionally assigned to foreign and domestic shareholders. Based on this analysis, the report asserted that 71 percent of oil sands production is owned by non-Canadian shareholders. Using the same methodology, but with slight variation in the companies examined, CAPP estimated that 67 percent of 2010 production is foreign-owned.

All the companies considered are publicly-traded companies, and all corporations in Canada are required to maintain a registry of their shareholders, including the names and latest known address of each shareholder. This is the same approach used by Statistics Canada (StatCan) to calculate the percentage under foreign ownership of Canadian enterprises for the purposes of the *Corporations Returns Act*. However, StatCan does not conduct or publish any analysis at the industry level of the percentage of share ownership that is foreign. StatCan focuses instead on foreign control based on assets, operating revenues and profits.

Overall, the Forest Ethics report fails to make an appropriate distinction between ownership and control. As a result, the report inflates the extent to which foreign entities are prevalent in Canada's oil sands sector.

Difference Between Equity Shares and Control

While measuring equity ownership by country of origin is one approach for assessing foreign ownership, Forest Ethics' analysis does not capture the control that foreign entities are able to exert within the oil sands sector. Foreign control, as determined by StatCan, measures the extent to which foreign entities are prevalent in Canada. According to StatCan, "country of control" is the country of residence for the foreign-controlling parent corporation. A corporation is foreign-controlled if more than 50 percent of the shares are owned by a foreign company.

Based on this definition, NRCan found that foreign-controlled companies were responsible for approximately 45 percent of overall oil sands capacity or production in 2011. This is similar to CAPP's analysis, which shows that 40 percent of 2010 production was foreign-controlled. It is important to note that the largest difference between 2010 and 2011 numbers is due to an increase in Shell's capacity, as its project at Muskeg River came online and as capacity at the Jackpine mine also increased. These figures are close to StatCan's published percentage of foreign-controlled assets in the oil and gas extraction sector of 35 percent in 2009.

Finally, all oil sands companies in Canada—regardless of ownership—operate under Canadian laws, accounting practices and tax regimes. Market-based investment: plays a crucial role in enabling Canada to realize its full economic potential; allows for the transfer of knowledge, technology and skills to domestic firms; and contributes to innovation, productivity and competitiveness gains. Canada is open to investment from foreign firms, as long as companies operate on market-based principles in Canada.

Benefits of Foreign Investment in Canada

Forest Ethics incorrectly states that Canadians receive little benefit from foreign investment in the oil sands. Canada's open investment climate plays a crucial role in enabling it to realize the full potential of its natural resource wealth. It also allows for the transfer of knowledge, technology and skills and contributes to innovation, productivity and competitiveness gains.

Furthermore, tax revenues and royalties accrue in Canada, while many oil sands profits are reinvested and contribute to employment and gross domestic product. According to ARC Financial, the oil and gas industry reinvested close to 90 percent of its retained earnings over the last decade. These reinvestments were used to finance new capital expenditures in Canada's oil and gas industry, which reached $57 billion (B) in 2011 or approximately 15 percent of all Canadian capital expenditures.

In addition, the oil and gas industry provides benefits to all Canadians in the form of government revenues. Over the last five years, revenues from crown royalty payments, exploration rights and corporate income tax have averaged around $22B per year. These government revenues help support critical government services, such as health care and education across the country.

Forest Ethics also states that only 0.8 percent of Canadian employment is attributed to oil sands production. In fact, that number represents total direct employment in the oil and gas industry, including conventional extraction and refineries. Beyond direct employment, oil sands development has significant far-reaching effects on the Canadian economy. In 2010, the Canadian Energy Research Institute (CERI) found that the oil sands directly and indirectly employed 390,000 people in Canada. This accounts for roughly 2.3 percent of Canada's total employment that year. CERI estimates that, from 2010 to 2035, the oil sands will support on average more than 700,000 jobs in Canada and inject up to $3.3 trillion into Canada's economy, if additional pipeline capacity is added.

Serge P. Dupont

Attachments: (2)

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# ANALYSIS OF FOREST ETHICS REPORT ON THE OIL SANDS

Forest Ethics examined 17 companies operating in the oil sands. These 17 companies represent approximately 95 percent of oil sands production. Their methodology is as follows:

- Percent of foreign ownership for each company was determined using investment figures obtained from Bloomberg in January, 2012.
- All the companies considered are publically traded companies and all corporations in Canada are required to maintain a registrar of their shareholders, including the names and latest known address of each shareholder. This is the same approach used by Statistics Canada to calculate the percentage under foreign ownership of Canadian enterprises for the purposes of the *Corporations Returns Act*.
- The percentage of shares held by foreigners is multiplied by the production capacity of each company, as reported in *Oil Sands Review*, such that capacity is proportionally assigned to foreign shareholders and domestic shareholders. The proportion of capacity allocated to foreign shareholders is determined to be 71 percent.

NRCan's analysis of Forest Ethics' four main conclusions of the report is presented below.

## (1) *Who Benefits? The Majority of the Tar Sands is Foreign Owned*

- This statement is misleading.
- Forest Ethics has confused country of control of a firm with its share ownership distribution. The most appropriate measurement of foreign companies' prevalence in Canada is foreign control.
- Based on NRCan's analysis and using Statistics Canada definitions (see Attachment 2), foreign controlled companies are responsible for 45 percent of overall oil sands approved capacity / production in 2011.
- Forest Ethics asserts that "companies doing business in the tar sands (i.e., headquartered in Canada, follow Canadian accounting practices, and traded on Canadian stock exchanges) are not truly Canadian." This statement is without foundation.

(2) ***Who Benefits? Not Eastern Canada***

- This statement is inaccurate.

- The assertion that Eastern Canada does not benefit at all from oil sands production is fundamentally untrue. All Canadians benefit from oil sands production in a multitude of ways, such as through employment, GDP and tax revenues. Eastern Canada is no different.

- A 2011 study by the Canadian Energy Research Institute estimates that, from 2010 to 2035, the oil sands will support, on average, more than 700,000 jobs per year in Canada and will inject up to $3.3 trillion into Canada's economy, if additional pipeline capacity is added.

- Eastern Canada will be a major beneficiary of oil sands growth. Under the same timeframe, CERI projects that on average, about 2000 jobs will be added per year in Atlantic Canada, including New Brunswick, Nova Scotia, Newfoundland and Labrador, and Prince Edward Island. Over the next 25 years, oil sands growth will contribute by $1.2 billion to GDP in New Brunswick, $1.3 billion to GDP in Nova Scotia, $545 to GDP million in Newfoundland and Labrador and $95 million to GDP in Prince Edward Island.

(3) ***Who Benefits? Over Half of Canada's Oil Revenue Goes to Foreign-Controlled Companies***

- This statement is misleading.

- This statement assumes that since the revenue is going to a foreign company, the benefits of this investment, (i.e. tax and royalty revenue) flow outside Canada. This is not true.

- Furthermore, most of the oil sands profits by firms operating in the oil sands (Canadian or foreign-controlled) are re-invested in Canada, contributing to employment and GDP growth.

*(4) WHO BENEFITS? THE TAR SANDS REPRESENT 0.8 PERCENT OF TOTAL CANADIAN EMPLOYMENT*

- This statement is misleading.
- The statement underestimates the current and future direct, indirect and induced employment impacts of the oil sands industry.
- Forest Ethics estimated that the oil and gas sector directly employed 118,011 people in 2008. Note, however, that in 2010, the Canadian Energy Research Institute (CERI) estimates that oil sands directly and indirectly employed 390,000 Canadians. In addition, in the same June 2011 study, CERI estimates that, between 2010-2035, the oil sands will support, on average, more than 700,000 jobs per year in Canada, should additional pipeline capacity be added.
- The benefits of oil sands development are not isolated to the extraction and construction industries, but also accrued to oil and gas support services across the country. For example, in Ontario, the oil sands industry directly and indirectly supported about 30,000 jobs in 2010. In British Columbia, almost 14,000 direct, indirect and induced jobs were supported by the oil sands sector.
- The cross-country benefits of oil sands development will grow alongside production increases forecast for the oil sands. According to CERI's 2011 study, from 2010-2035, the oil sands will support an average of 52,000 jobs in Ontario and 25,000 jobs in British Columbia per year, should additional pipeline capacity be added.

# WHO BENEFITS? AN INVESTIGATION OF FOREIGN INVESTMENT IN THE TAR SANDS

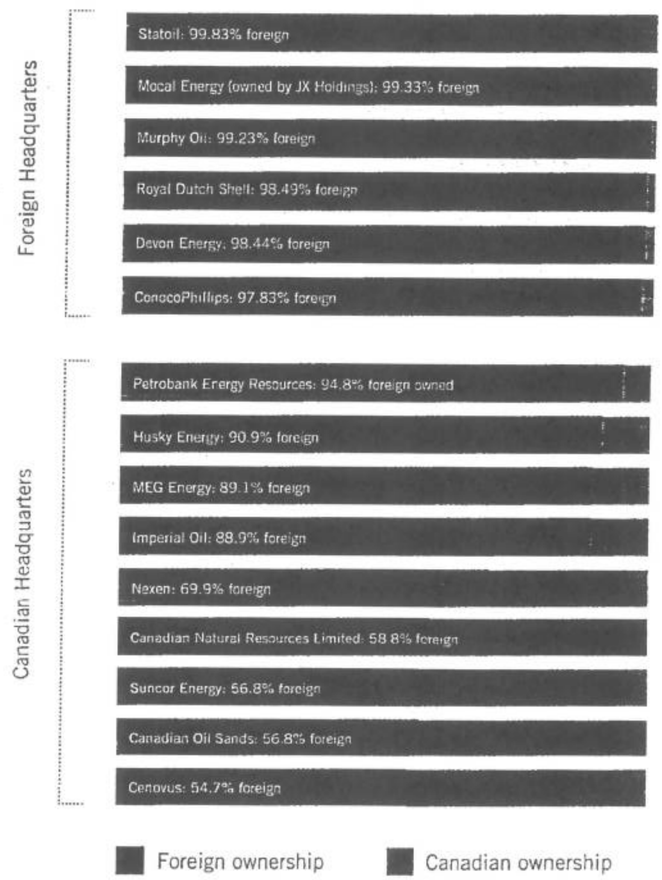
Making one industrial project a nation's nearly singular economic and policy priority puts Canada on a road straight to the 19th Century. The Government of Canada under Prime Minister Harper is taking a bad idea, compounding the risks and minimizing the Canadian rewards. The vast majority of tar sands production is not owned by Canadians and most of the profits from the resource go to foreign companies. An in-depth review of shareholder information from Bloomberg shows that 71 per cent of all tar sands production is owned by non-Canadian shareholders. Canada's national interest should come before the interest of foreign shareholders.

## #1 WHO BENEFITS? THE MAJORITY OF THE TAR SANDS IS FOREIGN OWNED

Canadian companies doing business in the tar sands (ie: headquartered in Canada, follow Canadian accounting practices, and traded on Canadian stock exchanges) are not truly Canadian. In reviewing data aquired by Bloomberg Professional, findings include that Husky Energy is 90.9 per cent owned by foreign shareholders, and Canadian Natural Resources Ltd. 58.8 per cent. Foreign headquartered companies representing a market capitalization of $391 billion, control 24.2 per cent of all tar sands production.

**Data acquired from Bloomberg Professional (29 Jan 2012) and production data acquired from *Oilsands Review* (Jan 2012)

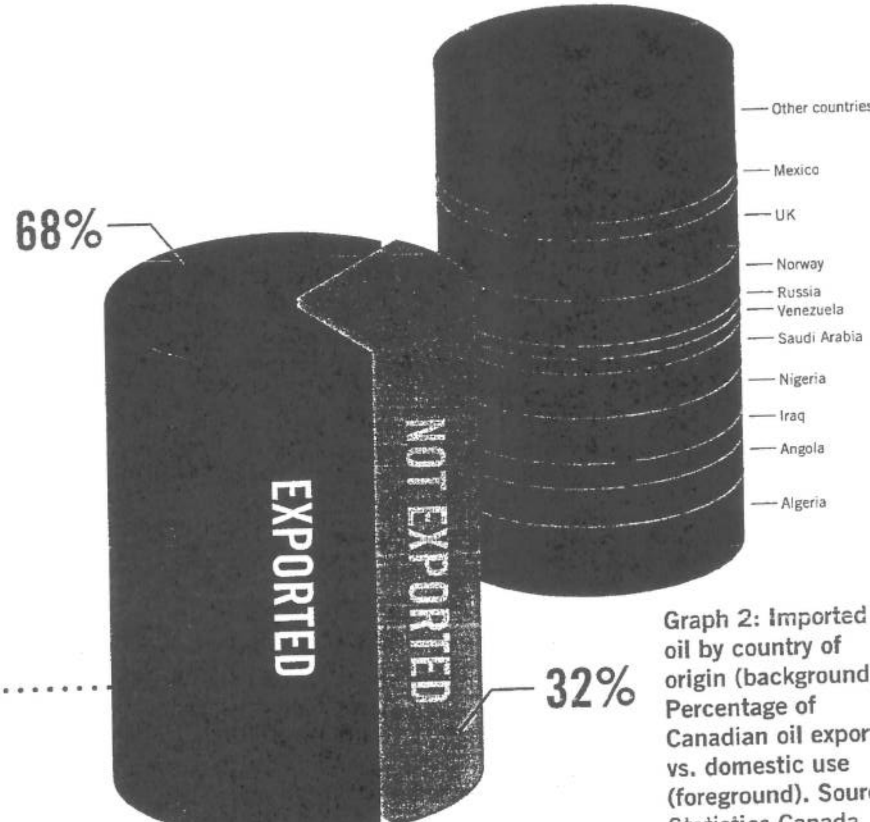
**Graph 1. Ownership of companies with tar sands operations (see right)**




> Why does the Canadian government place energy security for an authoritarian Chinese regime ahead of energy security for ordinary Canadians?
>
> **- Andrew Nikiforuk, award-winning author and journalist**

# #2 WHO BENEFITS? NOT EASTERN CANADA

Total Canadian oil production is 2.8 million barrels per day (1.6 million bpd from the tar sands). Of this, Canada exports 1.9 million barrels per day to the United States. Despite increasing tar sands production, Canada still imports 43 per cent of its crude from from Algeria, Iraq, Saudi Arabia, Nigeria, Venezuela, the UK and Norway. Nearly all of this foreign oil is destined for Eastern Canada.




Graph 2: Imported oil by country of origin (background) Percentage of Canadian oil exported vs. domestic use (foreground). Source: Statistics Canada

## RISING CHINESE INVESTMENT

Harper's policies are positioning Canada as China's resource colony:

« Of the $73.6 billion CAD invested in the tar sands between 2007-2011, based on public announcements, tar sands investments from China comprise 16% or $11.7 billion.

« These investments are from three major Chinese national oil companies (CNPC, CNOOC, Sinopec) and China's sovereign wealth fund (China Investment Corporation).

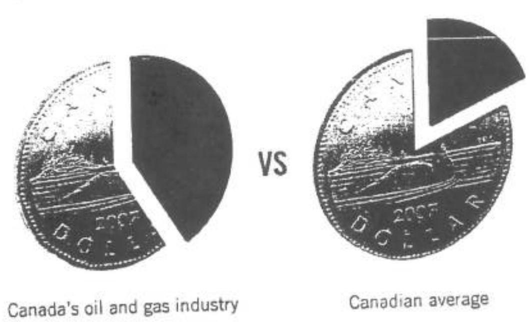
« Of Enbridge's known backers for its controversial Northern Gateway pipeline and tanker project, Sinopec, the seventh largest corporation in the world, has invested at least $10 million. A recent article reveals PetroChina's interest in not only purchasing an equity, but in also getting the contract to build the pipelines.

"They [PetroChina] have made the point to us that they are very qualified in building pipelines, and we will take that into consideration when we are looking for contractors ...It's an open bid process. They are a very big organization, they build a lot of pipelines, and they would love to be involved from what they have told me."

- Enbridge CEO Patrick Daniel quoted in the *National Post*

# #3 WHO BENEFITS? OVER HALF OF CANADA'S OIL REVENUE GOES TO FOREIGN-CONTROLLED COMPANIES

Over half (51.1%) of all oil and gas operating revenue in Canada goes to foreign entities compared to the national average of 28.5%. Canada's oil and gas industry has twice (41.3%) the amount of foreign controlled operating profit compared to the national average (20.1%).




**Graph 3: Operating Revenue Under Foreign Control (2009). Source: Statistics Canada**

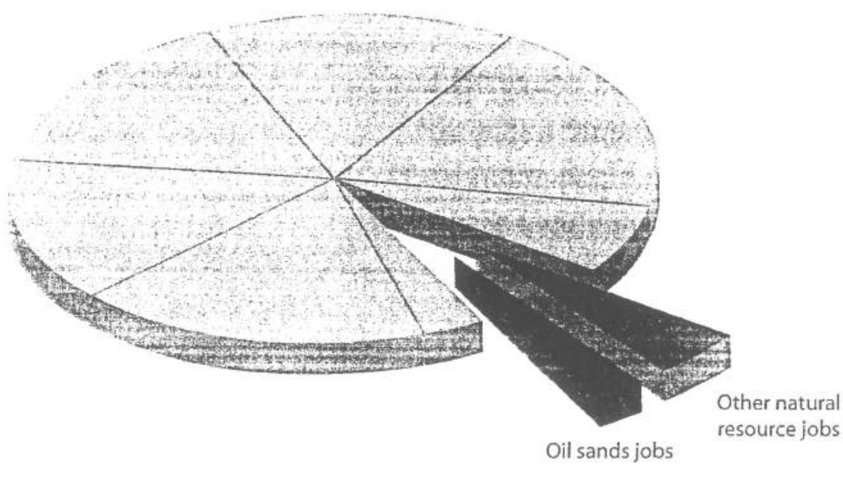
"We will uphold our responsibility to put the interests of Canadians ahead of foreign money and influence that seek to obstruct development in Canada in favour of energy imported from other, less stable parts of the world."

- **Prime Minister Stephen Harper**

## #4 WHO BENEFITS? THE TAR SANDS REPRESENT 0.8 PER CENT OF TOTAL CANADIAN EMPLOYMENT

The oil and gas industry is one of the most capital intensive sectors in the world. While jobs increase in construction with expansion projects, there are relatively few in day-to-day operations. In 2008, 56,283 workers were employed in all oil and gas extraction, a further 17,904 were employed in petroleum and coal product manufacturing, and 43,824 employed in support activities for mining and oil and gas extraction. This total of 118,011 represents 0.8 per cent of total Canadian employment.

**Graph 4: Canadian tar sands jobs as a percentage of total Canadian jobs**
Statistics Canada, Table 2810024 - Employment (SEPH), unadjusted for seasonal variation, by type of employee for selected industries. For the latter, 87,648 were employed in support activities for mining and oil and gas extraction. Employment in mining and oil and gas is roughly split between the two, so we assume the same for support activities.




"For every 400,000 barrels of raw bitumen a day that Canada exports, economists calculate that the nation sends approximately 18,000 upgrading and refining jobs abroad and reduces Canada's GDP by 0.2 per cent."

- **Alberta Federation of Labour**

# CONCLUSION

In looking at the tar sands, who benefits? Publicly traded oil companies with active tar sands operations have a very high level of foreign ownership – 71 per cent. Some notably Canadian oil companies such as Suncor, Canadian Oil Sands, and Husky are predominantly owned by non-Canadians. The data also shows us that more than half of Canada's oil and gas operating revenue goes to companies under foreign control.

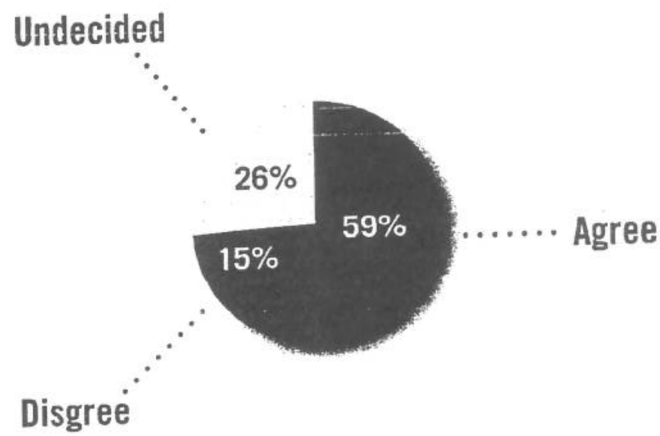
So, in whose interest is this Government of Canada serving? Since the beginning of the year, our Federal Government has either cut or gutted every piece of environmental legislation designed to protect our land, air, and water while aggressively pushing for the expansion of the tar sands and the building of new pipelines, such as the controversial Enbridge Northern Gateway pipeline and supertanker project. Harper has claimed to do this in the name of Canada's national interest while attacking anyone who disagrees.

There has been no debate – either publically or in the House of Commons – around a national energy strategy, how we want our natural resources managed, and what kind of energy future we want in this country. This conversation would provide greater insight into what Canadians think is in their best interest.

The Conservative Harper government is increasingly ruling in favour of foreign-oil companies instead of Canadians. We need foreign investment and shareholders in this country, but it does not need to be at the cost of democracy, our environment, and future generations.

**Canadians believe the government has put oil and gas companies' interests above those of Canadians**

Source:
"Feds set Canada back 50 years on environment regulations: critics", *The Hill Times*, April 30, 2012.

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ForestEthics ADVOCACY

# FOREIGN INVESTMENT IN CANADA'S NATURAL RESOURCES SECTOR

## OVERVIEW

- An open investment climate is fundamental to economic development, job creation and growth across Canada's economy. It enables Canadian firms to have access to assets abroad and to attract global investors that help finance and share risk on capital-intensive resource and infrastructure projects at home.

- Foreign direct investment (FDI) plays a key role in enabling Canada to realize the full potential of its natural resources wealth, and will be an important contribution to the more than $500 billion in energy and mining sector investment planned over the next 10 years.

- Canadian resource multinationals are also major players in the global marketplace. In 2011, the value of Canadian Direct Investment Abroad (CDIA) ($ 684.5 B) stock was larger than FDI stock in Canada ($607.5B).

- According to Statistics Canada, the majority of natural resources sector assets are Canadian controlled. In 2009, foreign control in Canada's mining industry (33.1%), and oil and gas sector (35.1%) ranked ahead of the average of all industries (19.7%), but behind others like manufacturing (53.8%) and wholesale trade (43%).

- Foreign control in the energy and mining sectors is dominated by the US and the EU.

## CHINA

- It is estimated that since 2005, China has invested about $17 billion in natural resources sector assets in Canada by way of mergers, acquisitions, and joint ventures, with over three quarters of this total in energy. Since 2007, China's investment in the oil sands is approximately $10.7 billion.

- China has also invested close to $20 billion in Canadian natural resource companies with assets abroad.

- Overall, China remains a small investor in Canada. It increased its FDI stock in Canada from less than 0.1% in 2001 to 1.8% of Canada's total FDI stock in 2011. The stock of Chinese FDI in the resource sector is small – estimated at about 3.4% of total FDI stock in the natural resources sector.

## OIL AND GAS / OIL SANDS

- According to Statistics Canada, 35% of the assets of the oil and gas sector were foreign controlled in 2009.

- This is comparable to analysis performed by CAPP based on 2010 production data, which found that 40% of the oil sands industry was foreign controlled, of which 29% is US-controlled and 11% is non-US foreign controlled. Using 2011 production/ approved capacity data, foreign control in the oil sands increases to about 45%. The largest difference between 2010 and 2011 numbers is due to an increase in Shell's capacity, as its project at Muskeg River came online, and capacity at the Jackpine mine also increased.

- While Statistics Canada does collect share ownership data of Canadian corporations under the Corporations Returns Act, it has not published nor conducted analysis for many years on the percentage of the oil and gas sector that is foreign-owned. It focuses its analysis instead on foreign control based on assets, operating revenues and profits.

- However, analysis performed by CAPP shows that 67% of the oil sands production in 2010 was foreign-owned, of which 52% is US and 15% is non-US foreign.

- This analysis is relatively comparable to that undertaken by *Forest Ethics* (based on investment figures obtained from Bloomberg in January 2012) which showed that 71% of oil sands production/approved capacity is owned by non-Canadian shareholders.

## FOREIGN CONTROL VS FOREIGN OWNERSHIP: DEFINITIONAL CONSIDERATIONS

Foreign control and the share of foreign ownership of companies operating in Canada are two different metrics to assess the extent of foreign prevalence in the Canadian corporate economy and can be explained as follows:

1. **Foreign control** gauges the degree to which a foreign investor or company has the ability to influence the strategic decisions of a domestic based corporation.

   According to Statistics Canada, the **'country of control'** of a given corporation refers to the country of residence of the ultimate controlling parent corporation, family, trust, estate or related group. That is, the country in which the largest holder of voting rights, or shares, is based. A corporation is determined to be foreign controlled if more than 50% of shares are owned by a single foreign entity. Each subsidiary within the global enterprise is assigned the same country of control as its parent. A company

whose voting rights are equally owned by Canadian-controlled and foreign-controlled corporations, is Canadian-controlled.

The level of foreign control can be applied to a number of different variables:

- Statistics Canada uses three components to measure foreign control: **assets**, which provide a longer term perspective; **operating revenues**, which are tied to the business cycle and, as a result, are more volatile than asset-based measures; and **profits**, which are a measure of the financial health of an industry and are used to assess its performance.

- CAPP and *Forest Ethics* based their measurement of foreign control on the share of overall **production** and/or **approved capacity** of each project under development.

2. **Foreign ownership** represents the degree to which foreign investors or foreign companies contribute to the capital formation of a domestic based corporation and, in turn, benefit from the profits of the corporation. Foreign ownership is based on the percentage of all company shares held by non-Canadian residents, ranging from shareholders with a high degree of control to those holding only a small number of shares and, as a result, are unable to actively influence the management decisions of the company.

   To determine ownership shares, Statistics Canada sends Canadian enterprises (e.g. corporations or consolidated entities) *Corporations Returns Act* forms to complete. Schedule II-Ownership forms require firms to indicate who owns their shares. The companies surveyed are generally publicly traded and all corporations in Canada are required to maintain a registrar of their shareholders.

## ECONOMIC CYCLE OF THE OIL AND GAS INDUSTRY

The attached chart prepared by ARC Financial describes the economic cycle of the oil and gas industry, including revenues, cash flow, reinvestment and payments to government for 2010.

Since 2005, oil and gas companies' revenues have generally been above the $100 billion mark, pushed by the sharp rise in the global price for crude oil, along with the switch away from natural gas to liquid-rich reserves. After a sharp decline in 2009 due to the global recession, total exploration and production revenues for Canada's oil and gas industry once again reached $100 billion in 2010.

Oil and gas companies must cover a number of costs from sales revenues, including royalties (generally paid to the provinces); taxes (federal, provincial and municipal), and operating expenditures (such as general and administration costs (G&A), interest

payments, salaries, and input costs), totaling about $55 billion in 2010.

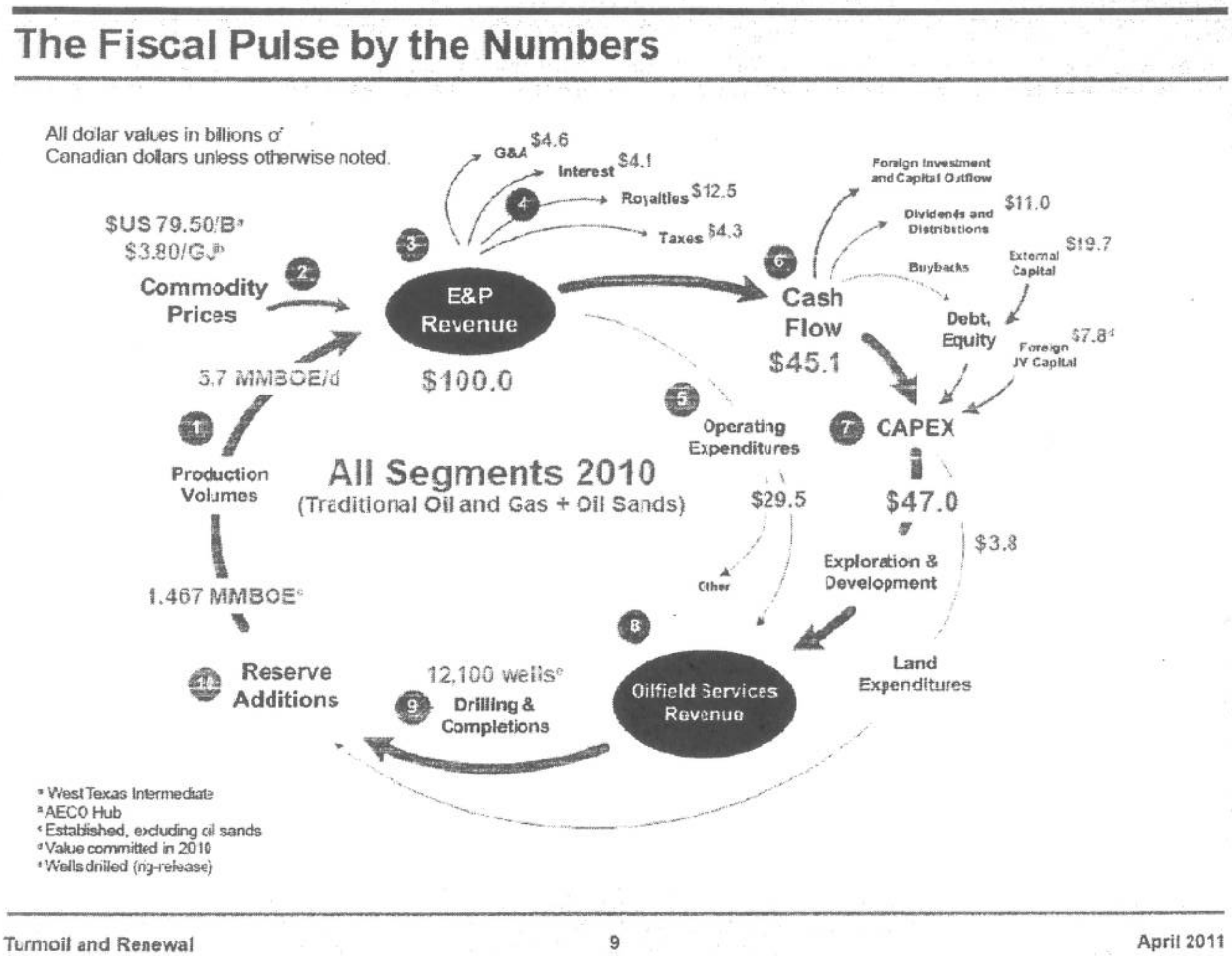
The remainder makes up the internal cash flow of the companies (about $45 billion in 2010), which is used, in part, to pay shareholders dividends and distributions (about $11 billion in 2010), as well as to make foreign direct investments abroad. The majority of these earnings were retained, however, and subsequently re-invested back into Canada in the form of capital expenditures (about $47 billion in 2010) and land payments to governments (about $4 billion in 2010) for exploration and development purposes.

While some of these capital expenditures were paid for in part by debt and equity raised in the markets (between $15 and $20 billion annually) and by foreign direct investment (mainly in the form of joint venture financing), the majority was financed by the internal cash flow of the companies operating in Canada. According to ARC Financial, the oil and gas industry reinvestment ratio has averaged close to 90% over the last decade, with the majority being reinvested back into Canada.

These reinvestments have contributed substantially to Canada's overall growth and employment. In recent years, the oil and gas industry has contributed about 7% (in nominal terms) to Canada's gross domestic product and has led to the creation of a number of jobs, both directly and indirectly, throughout Canada, including in such other industries as equipment manufacturing, construction and engineering services across the country.

In addition, the oil and gas industry provides benefits to all Canadians in the form of government revenues. Over the last 5 years, revenues from Crown royalty payments, exploration rights and corporate income tax have averaged around $22 billion per year. These government revenues help support critical government services, such as health care and education across the country.

**CHART 1: CAPITAL FLOW CYCLE OF CANADA'S OIL AND GAS INDUSTRY (2010)**




Source: ARC Financial